



STATE BOARD OF EQUALIZATION

450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0092
(916) 445-1441 • FAX (916) 322-7175
www.boe.ca.gov

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November 9, 2011

Dear Prospective Study Participant:

Our records indicate that your company may be eligible to participate in an upcoming study to be conducted by the Board of Equalization (BOE) in cooperation with industry regarding sales of non-custom software under technology transfer agreements (TTAs).

In the recent Nortel decision (Nortel Networks, Inc. v. State Board of Equalization (2011) 191 Cal.App.4th 1259), the California Court of Appeal determined that an agreement for the transfer of non-custom software could qualify as a TTA. As such, the sale or purchase of such software on tangible storage media could qualify as a TTA when the agreement for the sale or purchase also assigns or licenses the right to make and sell a product, or the right to use a process that is subject to a patent or copyright interest. Under the Sales and Use Tax Law, tax applies to the price paid for tangible personal property transferred in a TTA. In addition, under the Sales and Use Tax Law, the price paid for tangible personal property transferred under a TTA is:

1. The reasonable separately stated sale price for the tangible personal property stated in the TTA; or
2. If there is no separately stated reasonable sales price in the TTA, the separately stated reasonable price at which the tangible personal property was previously sold, leased, or offered for sale; or
3. If neither of the above exists, then 200 percent of the cost of the labor and materials used to produce the tangible personal property.

The Board authorized staff to conduct a cooperative study with industry to determine whether an optional percentage can feasibly be established for estimating the taxable portion of a TTA's lump-sum sale price for non-custom software and patent or copyright interests if the 200 percent formula had been utilized. A copy of the informal issue paper requesting the study is available on the BOE website at <http://www.boe.ca.gov/meetings/pdf/TTA-IIP.pdf>.

At this time, the BOE is looking for study participants who are willing to help staff develop an understanding of the cost accounting for software development and determine whether it is feasible to establish an optional percentage for estimating the taxable portion of a TTA's lump-sum sale price for non-custom software and patent or copyright interests. Participants in the study will remain anonymous. In addition, the BOE will maintain the confidentiality of the participants' records and the BOE will only release aggregated data to the public in order to avoid identifying the participants or their proprietary information. To participate in the study, we

are looking for individual companies, or representatives of individual companies, who meet the following criteria:


- Hold patent and/or copyright interests in the software sold;
- Make retail sales of non-custom software that are transferred on tangible storage media;
- Have knowledge of cost accounting and GAAP for software development costs; and
- Be willing to provide their cost accounting data to BOE staff.

As part of the study, the BOE is asking participants to explain how they account for costs incurred from the initial software development through the actual production and sale of the tangible media. The BOE would also welcome input on how GAAP affects the company's accounting for software development costs. In particular, staff would review a participant's:

- Chart of accounts;
- Criteria used to determine whether a cost is currently expensed or capitalized;
- Recording of software development costs;
- The effect of FASB/GAAP on the method of recordation;
- Amortization methodologies used for software development costs;
- Specific accounts used to record software costs;
- Costing records for determining per unit costs; and
- Methodologies for determining, for financial and cost accounting purposes, those costs expended for the development of software and those costs expended for the establishment of patents and copyrights.

If you would like to participate in the study or have any questions, please **contact Ms. Judi Pierce by December 9, 2011** at (916) 327-2045 or by email at judith.pierce@boe.ca.gov. Once we have compiled the list of willing participants, we will contact you individually with additional study information. We look forward to hearing from you.

Sincerely,



Jeffrey L. McGuire, Deputy Director
Sales and Use Tax Department

JLM: jp

cc: Honorable Jerome E. Horton, Chairman, Fourth District
Honorable Michelle Steel, Vice Chair, Third District
Honorable Betty T. Yee, First District (MIC 71)
Senator George Runner (Ret.), Second District (MIC 78)
Honorable John Chiang, State Controller, c/o Ms. Marcy Jo Mandel
Ms. Kristine Cazadd, Executive Director
Mr. Randy Ferris, Acting Chief Counsel
Ms. Susanne Buehler, Chief, Tax Policy Division, Sales and Use Tax Department
Ms. Judi Pierce